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AUG 1 3 2003

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

August 13, 2003

BY HAND DELIVERY

Marlene H. Dortch
Office of the Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20054

Re: ***Notice of Ex Parte Communication*** *in Consolidated Application of General Motors Corporation, Hughes Electronics Corporation, and The News Corporation Limited for Authority to Transfer Control (MB Docket No. 03-124)*

Dear Ms. Dortch:

In accordance with Section 1.1206 of the Commission's rules, 47 C.F.R. § 1.1206, this letter reports that on Tuesday, August 12, 2003, Dennis Carlton and Gustavo Bamberger of Lexecon, Inc. ("Lexecon"), Carl Shapiro, Steven Salop, and David Majerus of Charles River Associates ("CRA"), William Wiltshire and Michael Nilsson of Harris, Wiltshire & Grannis LLP and John Nannes of Skadden, Arps, Slate, Meagher, & Flom LLP on behalf of The News Corporation Limited ("News Corp."), Merrill Spiegel of DIRECTV, Inc., Bill Slowey of General Motors, Inc ("GM"), Gary Epstein and James Barker of Latham & Watkins LLP and Lawrence Secrest and Todd Stansbury of Wiley Rein & Fielding LLP on behalf of GM and Hughes Electronics Corporation (collectively, "GM/Hughes"), met with Barbara Esbin, Tracy Waldon, Marcia Glauberman, Keith Brown, and Peter Alexander of the Media Bureau, Simon Wilke, Donald Stockdale and Maureen McLaughlin of the Office of Strategic Policy, D. Anthony Bush of the Office of General Counsel, and Douglas Webbink, Marilyn Simon, and JoAnn Lucanik of the International Bureau.

At this meeting, the Lexecon and CRA economists made presentations discussing their respective submissions that were attached to Applicants' Opposition to Petitions to Deny and Reply Comments, filed on July 1, 2003. Redacted versions of their presentations are reflected in the PowerPoint slides shown at the meeting and attached to this letter. (Applicants are filing unredacted versions under separate cover.) The Lexecon and CRA economists also presented initial responses to the most recent submission by Professor William P. Rogerson of Northwestern University on behalf of the Joint Cable Commenters. These responses are also reflected in the attached presentation slides. Applicants also informed Commission staff that they intend to submit a further response to Professor Rogerson's submission in the near future. Finally, CRA distributed additional information on the formula underlying the results reflected in Table 7 of its earlier submission. A copy of that information is also attached to this letter.

In accordance with the First Protective Order in this docket, I am filing two copies of the redacted version of this letter and its attachments.

If you have any questions concerning this notice, please do not hesitate to contact me.

Sincerely yours,

William M. Wiltshire

William M. Wiltshire

Attachments

cc: Barbara Esbin
Tracy Waldon
Marcia Glauberman
Keith Brown
Peter Alexander
Simon Wilke,
Donald Stockdale
Maureen McLaughlin
D. Anthony Bush
Douglas Webbink
Marilyn Simon
JoAnn Lucanik

ATTACHMENT A

PRESENTATION OF LEXECON, INC.

News Corporation/DIRECTV Transaction: Economic Analysis

Dennis W. Carlton
Janice H. Halpern
Gustavo E. Bamberger

Lexecon Inc.

Presentation for FCC Staff

August 12, 2003

The Proposed Transaction Benefits Consumers

- **The proposed transaction promises substantial efficiencies.**
- **The empirical evidence shows that the transaction will not have anticompetitive effects.**
  - **No empirical evidence that News Corp. would "foreclose" rival MVPDs from News Corp. content.**
  - **No empirical evidence that News Corp. would increase the price of its content to DIRECTV's rivals.**

No Empirical Evidence that News Corp. Would "Foreclose" Rival MVPDs

- Key Point: News Corp. will not have a greater incentive to foreclose DIRECTV's rivals after this transaction than it does today.

- News Corp. could have offered DIRECTV an exclusive contract prior to the merger, but has not done so.
  - There is considerable indirect evidence that transactions costs of forming exclusives are not high.
  - Exclusives with MVPDs are rare.

- Thus, there is no evidence that News Corp. would have an incentive to transact exclusively with DIRECTV after the transaction.

Continued ...

No Empirical Evidence that News Corp. Would "Foreclose" Rival MVPDs

- The CRA numerical analysis of foreclosure confirms that an exclusive arrangement between News Corp. and DIRECTV would not be a profitable strategy in light of the empirical evidence.

- Indeed, Professor Rogerson appears to concede that the proposed transaction does not raise substantial "foreclosure" concerns.

No Empirical Evidence that News Corp. Would Increase the Price of its Content to DIRECTV's Rivals

- Even ignoring the program access rules and the parties' voluntary commitments, this transaction will not enhance News Corp.'s ability to increase programming prices.

- News Corp. already could obtain rents associated with that programming through contract.

- Yet there is no evidence of such contracts.

Professor Rogerson's Approach is Flawed

- **Professor Rogerson's theory is completely general, and implies that *any* vertical merger where an upstream firm sells to more than one downstream firm should be blocked, absent a showing of substantial efficiencies.**

- **For example, the theory applies to all prior vertical transactions in the cable industry and would imply that all such transactions should have been blocked.**

Lexecon Bottom Line

- The proposed transaction raises no anticompetitive concerns.

- The proposed transaction will benefit consumers.

ATTACHMENT B

PRESENTATION OF CHARLES RIVER ASSOCIATES

News Corporation/DIRECTV Transaction: Economic Analysis

Steven C. Salop, Carl Shapiro, David Majerus, Serge Moresi, and E. Jane Murdoch

Charles River Associates

DIRECTV Lacks Dominance in MVPD Markets

- DIRECTV's Share is 13% Nationally
  - 10% Facing Larger Cable Operators
  - 15% to 20% in Rural Counties
- EchoStar is a Direct, Nationwide Rival
- DIRECTV Service is Provided by NRTC in Many Rural Areas

News Corporation Programming: Sports Networks and O&Os

- NewsCorp Programming Already Priced to Maximize Profits
  - RSN Affiliate Fees Per Sub Per Month
  - O&O Retransmission Rights
- Any Price Increases by NewsCorp Involve Risk: Loss of Carriage
  - True Both Before and After Transaction

Key Element Missing: DIRECTV Cannot Gain Dominance

- Transaction is Vertical
  - DIRECTV is Distributor with No Meaningful Stake in Programming
  - NewsCorp is Content Provider
  - No Meaningful Horizontal Overlap
- NewsCorp Programming Cannot Plausibly Be Used to Give DIRECTV a Dominant Position in MVPD Markets

Denial of Programming to Rival MVPDs Would be Unprofitable for NC

- **Big, Certain Loss of Programming/Ad Revenues**
  - Loss is Immediate & Substantial Due to Rivals' Large Share of MVPD Subscribers
- **Benefits Are Highly Uncertain, Smaller**
  - Based on Subscribers Switching to DIRECTV in Response to Denial – Speculative
  - News Corp Captures Only 34% of Any DIRECTV Gains That Do Occur
  - Sports Teams Would Resist in Short Run, Demand Share of Rents in Long Run, if Strategy Were Successful

Subscriber Gains Necessary for Profitability are Implausible

- **We Have Calculated the Magnitude of Subscriber Switching or Revenue Increase Necessary to Make Denial of Programming Profitable for News Corp**
- **Strong and Robust Implausibility Findings Based on Market Shares, Margins**
  - **Findings Consistent w/ Rarity of Exclusives, Empirical Evidence from Natural Experiments**

Vertical Arithmetic: National Shares

Foreclosure of MVPD Rivals: Profitability Analysis		
News Corporation Programming Withheld	***DIRECTV Subscriber Increase Required to Break Even***	***DIRECTV Revenue Increase Required to Break Even***
Regional Sports Network	**128%** **From 13% to 30% Share**	**49%** **Increase from**
Owned & Operated Station	**306%** **From 13% to 53% Share**	**175%** **Increase from**
Owned & Operated Station (A/B Switch)	**241%** **From 13% to 44% Share**	**117%** **Increase from**

Vertical Arithmetic:
Smaller Cable Operator Areas

Foreclosure in Small, Rural Cable Franchise Area (Updated Data--Rivals' Share 81%, DIRECTV 13%, NRTC 6%): Profitability Analysis

News Corp. Programming Withheld	*DIRECTV Subscriber Increase Required to Break Even*	*DIRECTV Revenue Increase Required to Break Even*
Regional Sports Network	100% From 19% to 38% Share	46% Increase from
Owned & Operated Station	222% From 19% to 61% Share	163% Increase from
Owned & Operated Station (A/B Switch)	180% From 19% to 53% Share	109% Increase from

Empirical Evidence: *YES* Experience in New York

- *YES* Network -- NY Yankees & NJ Nets
- Natural Experiment: During 2002, DIRECTV Had *De Facto* Exclusive on *YES*
- Cablevision Lost Fewer Than 30,000 out of Three Million Subscribers During 2002
  - 30,000 is Upper Bound on Subscriber Switching Due to Lack of *YES* Network on Cablevision
  - Upper Bound is 1% of Cablevision Subscribers

YES Experience Shows Denial of Programming Would Be Unprofitable

- Very Large Loss of Programming/Ad Revenue

- Any DIRECTV Gains Were Far Smaller

  –

- Not A Close Call: Foreclosure Clearly Unprofitable

News Corp Lacks Incentives to Impose a Uniform Price Increase

- **Concern: Would Transaction Cause News Corp to Raise Prices Across-the-Board Instead of Denying Programming to Rivals?**
  - **Assuming Uniform Price Increase Would Not Violate the Commission's Program Access Rules**
- **Answer is "*NO*"**
  - **Very Strong and Clear Economic Result**
  - **Transaction Puts *Downward* Pressure on NewsCorp Programming Prices, *Ceteris Paribus***

Why Transaction Puts Downward Pressure on Programming Prices

- **Higher Uniform Prices Reduce Programming Profits**
  - **Prices Already Set by NC to Maximize Profits**
- **Higher Uniform Prices Reduce DIRECTV Profits**
  - **Higher Costs for DIRECTV, And No Competitive Advantage Over MVPD Rivals (Since Price Increase is Uniform), So No Gain in DIRECTV Subscribers**
- **Bottom Line: NC Stake in DIRECTV Gives *New* Reason *Not* to Raise Programming Prices**

Comments on Rogerson Submission

- Temporary Disruption
- Bargaining Theory
- Joint Profit Maximization

CRA Bottom Line

- DIRECTV Faces Strong Competition in MVPD Markets
  - Key Element of Vertical Case Is Missing
- Programming Foreclosure by NewsCorp Would Not Be Profitable
  - Vertical Foreclosure Analysis
  - Empirical Evidence (*YES* Natural Experiment)
- Transaction Will Not Give NewsCorp Ability or Incentive to Raise Programming Prices

ATTACHMENT C

ADDITIONAL INFORMATION ON CRA SUBMISSION

Formulas for DIRECTV Subscriber Increase and DIRECTV Revenue (per subscriber) Increase Calculated in Table 7 of the CRA Report

Notation

S_C	Small cable operator's share of MVPD subscribers
S_D	DIRECTV's share of MVPD subscribers
M_D	DIRECTV's margin per subscriber
M_F	Fox O&O's station and network advertising revenue per subscriber
d_D	Percentage of subscribers leaving cable that go to DIRECTV (assumed value is 60%)
d_E	Percentage of subscribers leaving cable that go to EchoStar (assumed value is 40%)
W	Percentage of subscribers remaining on cable that use A/B switch (assumed value is either 0% or 33%)
A	News Corp. acquired ownership interest in DIRECTV (assumed value is either 34% or 50%)
S^*	DIRECTV subscriber gain required for profitability (in share points)
P^*	DIRECTV revenue increase required for profitability (in dollars per subscriber)

Formulas

Subscriber Increase:

$$S_C \times M_F \leq$$
$$S^* \times (M_D \times A + M_F) + (d_E / d_D) \times S^* \times M_F + (S_C - S^* - (d_E / d_D) \times S^*) \times W \times M_F$$

Price Increase:

$$(100\% - W) \times S_C \times M_F \leq P^* \times S_D \times A$$